Supreme Court, U. S.
FILED
FEB 6 1979
MICHAEL RODAK, JR., CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1978

No. 78-818

TENNESSEE-CAROLINA TRANSPORTATION, INC.
PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE
RESPONDENT

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

PETITIONER'S REPLY TO RESPONDENT'S MEMORANDUM IN OPPOSITION

H. STENNIS LITTLE, JR.
JOHN B. OWENS, JR.
LITTLE, THRAILKILL
AND OWEN, P.C.
25th Floor
First American Center
Nashville, Tennessee 37238

In the Supreme Court of the United States

OCTOBER TERM, 1978

No. 78-818

TENNESSEE-CAROLINA TRANSPORTATION, INC.
PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE
RESPONDENT

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

PETITIONER'S REPLY TO RESPONDENT'S MEMORANDUM IN OPPOSITION

Pursuant to Rule 24(4) of the *Rules of the Supreme Court of the United States*, the Petitioner makes this reply to the Respondent's Memorandum in Opposition to Tennessee-Carolina Transportation, Inc's Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit.

In his Memorandum in Opposition to the Petition for a Writ of Certiorari, the Commissioner argues that the lower Court's decision has correctly interpreted the tax benefit rule. Secondly, he argues that the decisions

below do not conflict with Section 336 of the Internal Revenue Code. Finally, the Respondent argues that the decision below is not in conflict with *Commissioner* v. *South Lake Farms, Inc.*, 324 F.2d 837 (C.A.9, 1963). These contentions will be answered seriatim.

The Respondent on pages two through four of his memorandum argues for the continuing validity of the tax benefit rule. The Petitioner is not contesting the validity of the tax benefit rule. It is only contesting its interpretation and application by the Tax Court and the Court of Appeals for the Sixth Circuit in a new and novel way. On page three of his Memorandum in Opposition, Respondent sets out the following principle:

> The principle is well ingrained in our tax law that the *return or recovery* of property that was once the subject of an income tax deduction must be treated as income in the year of its recovery. [Emphasis Added]

The Respondent's argument glosses over the lower Courts' new and novel application that ignores the lack of an actual return or recovery of property by Service Lines, Inc., the liquidating corporation. The recovery, if any, was by the old shareholders of Service. Thus ignoring the absence of a recovery, the Respondent merely argues the validity of the tax benefit rule. His argument neglects the fact that the lower Courts have applied this important judicial doctrine in a manner that conflicts with all previous Court decisions applying the tax benefit rule.

Secondly, the Respondent asserts that the decisions below do not conflict with Section 336 of the Internal Revenue Code. The plain language of that Section clearly provides that "no gain or loss should be recognized to a corporation on distribution of property in partial or complete liquidation." Yet, that has happened in this case. The Respondent justifies his position by equating a liquidation under Section 337 of the Internal Revenue Code to the present liquidation under Section 336 of the Internal Revenue Code. What the Respondent fails to recognize in his argument is the existence of an actual recovery by the corporation liquidating under Section 337. In a Section 336 liquidation, the recovery, if any, is by the shareholders not the corporate taxpayer.

Finally, the Respondent argues that the decisions do not conflict with *Commissioner* v. *South Lake Farms, Inc., supra.* In his Memorandum in Opposition, the Respondent implies that only the dissenting circuit judge recognizes *South Lake Farms, Inc.* to be *contra* to the majority holding in this case. This implication by the Respondent ignores the majority's holding that there need not be an actual physical "recovery" of a tangible asset or sum in order to apply the tax benefit rule. Even the majority of the Court of Appeals realized this holding was in conflict with *South Lake Farms, Inc.* (See footnote 13 of the majority opinion wherein they state that "We reject the contrary holding in *Commissioner* v. *South Lake Farms, Inc. . . .*" (Pet., App. B-6)).

In his attempt to distinguish the conflict between *South Lake Farms, Inc.* and the present case, the Respondent relies on *Spitalny* v. *United States*, 430 F.2d 195 (C.A.9, 1970) and *Home Savings and Loan Association* v. *United States*, 514 F.2d 1199 (C.A.9, 1975), cert. denied 423 U.S. 1015 (1975). His purpose is to contest the continuing validity of *South Lake Farms, Inc.* as the law in the Ninth Circuit. However, those cases do not resolve the conflict since *Spitalny* involved a Section 337 liquidation rather than the present Section 336 liquidation. Moreover, *Home Savings and Loan Association* does not stand for the

proposition that the tax benefit rule requires the inclusion in income of a bad debt reserve by a savings and loan association liquidating under Section 336. The ultimate issue in *Home Savings and Loan Association* was whether or not the corporations had undergone a statutory reorganization pursuant to Section 368(a)(1)(A) or had undergone a liquidation with the basis of the assets being determined under Section 334(b)(2). The significance of the ultimate issue is that Section 593 requires the previously deducted bad debt reserve to be included in income only upon liquidation. Since there was a liquidation, Section 593 and not the tax benefit rule required that the nonrecognition provisions of Section 336 be overridden. This situation is similar to the holdings that the recapture provisions of Section 1245 will override the nonrecognition provisions of Section 336. Consequently, the decision of the Ninth Circuit in *South Lake Farms, Inc.* is still the law in that Circuit and is in direct conflict with the decision of the Sixth Circuit in the present case.

Respectfully submitted,

H. STENNIS LITTLE, JR.
JOHN B. OWENS, JR.
LITTLE, THRAILKILL
AND OWEN, P.C.
25th Floor, First American Center
Nashville, Tennessee 37238
(615) 259-3456